

DEPARTMENT OF MUNICIPAL FINANCE


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TOWN OF NANTUCKET

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16 Broad Street  
Nantucket, MA 02554

TO: C. Elizabeth Gibson  
Town & County Manager

FROM: Brian E. Turbitt   
Town & County Director of Finance

CC: Audit Committee

DATE: May 16, 2016

RE: Management Letter Progress Update

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### **Informational Items (pages 5 & 6)**

#### **Effect of Adoption of New Accounting Principal – Pensions**

The Town is aware of the New Accounting requirements for the pension system; and understands the importance of this new requirement. If requested by Barnstable County or its auditors the Town will provide the requested information in a timely and efficient manner.

#### **New Accounting Principal – OPEB**

The Town is in the process of reviewing the new requirements to better understand the impact on the financial statements. This includes continued discussions with our auditors; and offsite instructional conferences that address the complicated areas. As a result, the Town is confident that it will implement this standard by fiscal 2018 or sooner.

#### **Changes to the Single Audit Requirements**

The Town has begun reviewing the GAO Greenbook, and is in the process of developing a timeline for implementation. It is expected that this will be substantially complete by June 30, 2017.

#### **Municipal Data Breaches**

As noted in the informational item, the Town currently takes a proactive approach to network security. This will continue to be monitored to protect the security of the network and the information stored on the network. Vulnerable areas will be remediated immediately.

### **Findings and Comments (pages 7-11)**

- A. Status of Prior year items** – The Town continues to work on the remaining list of outstanding items, from not only the management letter, but the two operational reviews that were completed. There are still a few remaining items that are open at this time; it is expected that

the remaining items will be addressed and closed by the end of FY16; or a plan will be in place to complete as near the end of FY16 as possible.

- B. Student Activities** – This has been reviewed with the auditor and is working as designed. The reconciliation is being done monthly and is working as planned.
- C. Closing Process** –The Finance Department continues to work on the close process, and has developed the close schedule as the outline for what needs to be done and by when. Reviews of the process and the close itself are being done as we progress each month.
- D. Special Revenue Funds** – The Town is in the process of reviewing the funds and will work with the departments responsible to determine the disposition or use of the remaining balances in the identified funds. Annually, as part of the fiscal year closing process, the Town will review the special revenue funds, to ensure that funds are spent, or closed as necessary.
- E. Cash Handling Tests** – The Finance Department has substantially completed its initial review of the departments which handle cash. There have been no major issues found in the departments reviewed to date. There have been minor issues related to timing of turnovers, and making sure everything is documented. The issues have been discussed with the departments, we will continue with the reviews as previously discussed.

**TOWN OF NANTUCKET, MASSACHUSETTS**

**MANAGEMENT LETTER**

**YEAR ENDED JUNE 30, 2015**

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Honorable Board of Selectmen, Audit Committee  
and Town Manager  
Town of Nantucket, Massachusetts  
16 Broad Street  
Nantucket, Massachusetts 02554

We have audited the financial statements of the governmental activities, the business type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Town of Nantucket, Massachusetts (the "Town") as of and for the year ended June 30, 2015, which collectively comprise the Town's basic financial statements and have issued our report thereon dated January 15, 2016. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### Internal Control Over Financial Reporting

Management of the Town is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Town's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Town's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the Board of Selectmen, Audit Committee, Town Manager and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Roselli Clark & Associates". The signature is written in dark ink and is positioned above the printed name of the firm.

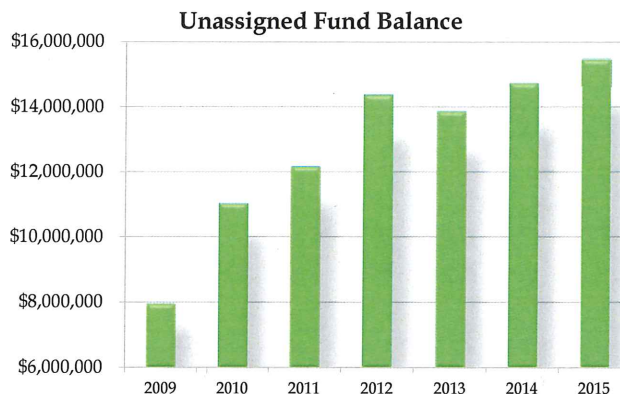
Roselli, Clark & Associates  
Certified Public Accountants  
Woburn, Massachusetts  
January 15, 2016

## I. OVERVIEW

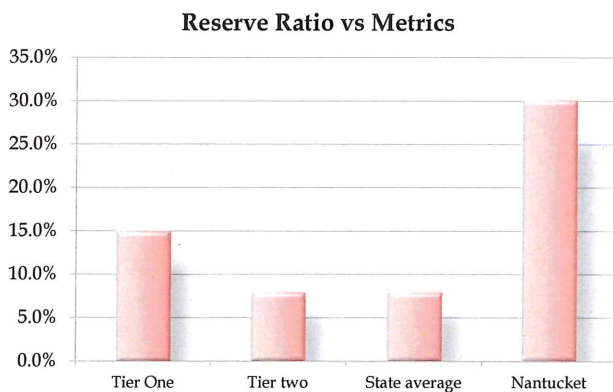
Fiscal year 2015 was a financially positive year for communities in Massachusetts. Many experienced increases to their reserve balances as average balances statewide increased to approximately 8% of general fund expenditures. In addition, unemployment rates have been reduced to pre-recession levels; and a favorable mortgage market has bolstered home sales which have been robust over the past 2 years. This has been especially true in Nantucket where real estate sales for calendar year 2014 exceeded \$1 billion for only the third-time in island history and assessed valuation has exceeded \$20 billion for the first time since fiscal year 2010; currently fourth highest in Massachusetts.

The Town ended the year with almost \$15.5 million in unassigned fund balance; and its OPEB Trust Fund which was established in fiscal year 2011 increased to \$0.8 million.

This represents a \$0.7 million increase in unassigned fund balance from the prior year and was primarily due to better than expected local receipts combined with expenditure turn-backs. This was particularly impressive given there were moderate uses of free cash and continued excess levy capacity.



A common budgetary flexibility test used by the rating bureaus when conducting a credit evaluation is called a reserve ratio. The ratio is calculated by adding general fund assigned and unassigned fund balances presented in the financial statements and dividing



this by the general fund expenditures. 15% is considered tier-one and 8% - 15% is considered tier-two. The Town's ratio is 30.2% which places the Town considerably higher than these critical rating metrics; and is considered very strong.

These strong reserve levels, when combined with the Town's strong management practices and excellent demographics, directly contributed to an upgrade in the Town's bond rating from Aa2 to Aa1 during the fiscal year. This is one notch below the highest investment grade possible and the Town should be proud of this achievement.

Another significant highlight for the Town was the completion of a Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2014. In June, 2015, the Town received notification from the Government Finance Officers Association (GFOA)

that the CAFR satisfied all the necessary reporting requirements to qualify for the prestigious Certificate of Achievement for Excellence in Financial Reporting. This was a major accomplishment for the Town, especially in light of the financial reporting issues that existed as late as 2013, when the Town was still included on the Department of Revenue watch list. The Finance Office now includes as one of its annual financial goals, the completion of a CAFR.

The remainder of the report is dedicated to informational items, and recommendations for improvement in control and efficiencies in operations. We urge the Town to implement recommendations where appropriate and cost/beneficial to do so.



## **II. INFORMATIONAL ITEMS**

### ***Effect of Adoption of New Accounting Principal – Pensions***

In fiscal year 2015, the Town and virtually all municipalities in the Commonwealth adopted new pension accounting standards. The new pension accounting standards required, for the first time, that the Town present its portion of the unfunded pension liability owed to its current and former employees in the government-wide financial statements. At June 30, 2015, the net pension liability for the Town was approximately \$53.7 million.

It is important to note that the new pension accounting standards do not affect the underlying regional pension system or its funding schedule. All Massachusetts pension systems are required by Massachusetts general law to be fully funded by June 30, 2040. The Barnstable County Regional Retirement System, which is the pension system the Town participates in, is currently 60.4% funded based on a December 1, 2014 actuarial study and actual pension plan net assets as of December 31, 2014.

The new pension accounting standards will require that the Town become a more active participant in the audit of the Barnstable County Regional Retirement System. The Town can expect to have its retiree and employee census data tested on a rotational basis. It is therefore important that the Town promptly provide the requested documentation to the Barnstable County Regional Retirement System and its auditors in a timely manner so as to not delay this annual process of it and all other employer units of the retirement system.

### ***New Accounting Principal – OPEB***

The Governmental Accounting Standards Board, or GASB, has issued a new pronouncement related to other postemployment benefits, or OPEB, that is substantially similar to the pension standard described above. OPEB typically includes health and welfare plans and other similar benefits provided to Town retirees exclusive of pension benefits.

Currently, the Town reports a net OPEB obligation (about \$38.7 million) in its government-wide financial statements. However, the proposed new accounting standards will require that the net OPEB liability (about \$88.8 million), be reported in the government-wide financial statements. Adoption of this new accounting standard is two years away for the Town.

While this proposed accounting standard will likely materially affect the Town's financial position, the Commonwealth has not passed legislation requiring municipalities to begin setting aside monies for this unfunded obligation like it has with pensions.

In order to begin to manage its OPEB obligation, the Town has established a formal OPEB trust fund like many other Massachusetts municipalities have done; and during fiscal year 2015 contributions increased the balance to approximately \$800,000. It is

expected that the Town will continue to fund part of its OPEB obligation annually and increase this funding in future years. This should have a positive impact on the Town's credit rating once the balance begins to accumulate.

### ***Changes to Single Audit Requirements***

The Office of Management and Budget, or OMB, raised the threshold for OMB A-133 compliance audits (i.e., single audits) from \$500,000 to \$750,000. This new threshold is expected to apply to the Town in fiscal year 2016. However, the Town generally exceeds the new \$750,000 threshold so it should continue to plan on having a single audit performed for the foreseeable future.

Also included in the new audit requirements is a requirement that the Town's internal control structure should be in compliance with recognized internal control framework such as the Green Book or COSO. At first pass, this requirement doesn't seem overly complicated. However, history has shown that seemingly harmless words similar to these can cause an entity to expend significant time and monetary resources in order to comply.

Adopting a formal internal control framework is new to municipalities and will likely require a good deal of evaluation, documentation, remediation and ongoing monitoring. We recommend that the Town commence this process by taking a common sense approach and tackle the areas in which the Town is most susceptible to an internal control deficiency. Over a period of time, the Town should complete the formal adoption of an internal control framework.

### ***Municipal Data Breaches***

We have alerted the Town in the past to be aware of network security. This informational item is being reported again as a reminder to continue to be vigilant. The past 12 months in Massachusetts have seen significant increases of breaches in local networks, some with reported attempted thefts in the millions.

The Town takes a proactive approach to IT security. We recommend that the Town continue to place an emphasis on IT security and continually update its IT security appliances and software as well as its policies and procedures regarding IT security.

### **III. FINDINGS AND RECOMMENDATIONS**

#### **A. Status of Prior Year Items**

- The errors regarding the filing of unemployment claims which caused a deficit in the prior year have been resolved through a revision of the reporting and review process in this area. Proper rates are now being used.
- The internal accounting for the Health Insurance Trust has been revised to include an employee and employer portion of activity and equity in the general fund.
- Analyzing old outstanding receivable balances that have remained on the books for a number of years is a process that is currently ongoing. It involves several moving parts including the Assessor's Office, Deputy Collector, Collector's Office, Finance Office and possibly DOR. The Town expects to resolve this by the close of fiscal year 2016.
- Establishing more efficient procedures with respect to receivable reconciliations at year-end is a goal for the 2016 year-end close. Although many of the timing items identified in the prior year did not exist at the end of fiscal year 2015; improving the overall process by the end of the fiscal year is a goal of the Finance Office.
- Improving the cash reconciliation process has been a goal for the last few years. While the process has shown some improvement and older reconciling items have been resolved and adjusted, the existence of new reconciling items continues to be an issue. Like the receivable reconciliation process identified above, improving this by the end of fiscal year 2016 is a goal of the Finance Office.
- The Town's overall closing process continues to be an issue. More specific details and an expansion of the prior year comment are included under current year findings later in this report.
- The Town is reviewing stagnant capital project balances and using those for similar type projects where legally permissible. Those needing re-appropriation are being submitted as part of an article at Town Meeting. The goal is to have exhausted all available stagnant funds by the close of fiscal year 2016 if possible.
- The issues identified in the payroll and DPW reviews have been incorporated into a plan with goals and timelines. Progress has been made on the less complicated items; the other more time consuming implementations are expected to be completed by the end of calendar year 2016.

#### **B. Student Activities**

As part of the fiscal year 2015 audit, a follow-up was conducted regarding the status of observations made during the fiscal year 2013 audit. Many improvements were made to the process and a stand-alone report has been issued to the School Committee regarding the remaining findings. One of the remaining issues impacts the Town's Finance Department and thus is communicated in this letter. Since a



significant portion of the Student Activity equity balances is in the custodial possession of the Town Treasurer, and a general ledger account is maintained as an Agency Account in the Town's records, those balances are needed by the School Department in order to conduct a complete reconciliation of their balances on a monthly basis. This has not been done in either of the last two years and we suggest this process begins immediately.

### **C. Closing Process**

As discussed under "status of prior year comments" the closing process continues to be a challenge for the Town.

The following are some of the issues observed when reviewing the closed balance sheet:

1. The Self Insured Health Trust final balance did not include an accounts payable amount for the last month of the year. This was a finding in fiscal 2013, corrected in 2014 and a finding again in 2015.
2. The required warrants payable entry made at year-end that represents a reconciling item between the Treasurer and the General Ledger was posted completely to the General Fund instead of spread across the multiple funds it impacted. This caused reconciliation issues when attempting to reconcile individual funds outside the General Fund.
3. The backup information for the journal entries made to the general ledger accounts was not always complete and often lacked explanation and/or supporting documentation which made the process of analyzing the entries inefficient.
4. Split payroll at year-end was not verified through a reconciliation process, instead complete reliance was placed on the entries generated by MUNIS.
5. Capital asset additions for outside departments, specifically Wannacomet Water and the Airport were not completed and reconciled to the Town's Capital Projects in a timely manner.
6. Other more minor issues also existed that were discussed with the Finance Office prior to our departure.

The Town is a very complicated entity with numerous enterprise funds and many departments and components acting somewhat autonomously. This causes the closing process to have multiple moving parts. The process needs to be planned in advance with the use of checklists and timelines and needs to be completed well before the audit team arrives. We suggest the Town implement such procedures, to improve the overall closing process.

#### **D. Special Revenue Funds**

Recently, the Department of Revenue appointed a new Director of Accounts. The individual has significant government finance skills which were accrued in her earlier career as a CPA in the municipal sector. One of the initial requests made by the new Director to the auditing group was to review the status of stale special revenue accounts. Many of these accounts become forgotten over years as individuals in charge of them retire or posting errors occur and are never corrected. In these instances, the new Director suggested that efforts are made to determine the true origin and purpose of the funds and if efforts fail, to make a one-time house cleaning entry to journalize these funds to the general fund as miscellaneous revenue. This will make efforts at the DOR level more efficient as it would remove the need for the field reps to review these stale accounts year after year to no avail.

We filtered through the Town's 200+ Special Revenue accounts and determined about 40% of the accounts, totaling \$953,240 have not had any activity in over two years and \$228,286 had no activity during fiscal year 2015. In many of the accounts it is obvious that coding errors occurred in prior years and have gone undetected; for example School grants that have been closed out with the State years ago most likely had expenditures posted to the General Fund in error and are still being carried because in years past, the Town was not reconciling grants with the School.

We suggest the Town Finance Office review the list we have prepared and begin analyzing those items that may be journalized, or used by a department head that has no knowledge the funds still exist.

#### **IV. CASH HANDLING TESTS**

As part of our risk assessment process, we reviewed certain cash handling areas in Town to determine if register balances reconciled to tapes used at the register. This is an area that will be conducted annually, on a surprise rotating basis, as part of the audit.

The following areas were reviewed with the corresponding results:

##### *Town Clerk*

Our observation test of the register process at the Town Clerk office detected a number of control issues as follows:

- The Clerk has been provided with a cash register however it is not used and instead a cash box is used.
- A tally sheet is maintained by category (i.e. birth certificates, marriage certificates, livery permits etc.) however it is not fully completed. The office staff communicated that it gets too busy to complete the tally sheet at the time of a transaction so best guesses are made to complete the sheet when a turnover is created weeks later. This however compromises any possible reconciliation since the tally sheet is adjusted to the cash on hand. Also, the guess work can't be accurate since many transactions are completed with cash and guessing what the cash was two weeks later is more "hit or miss" than accurate.
- We completed a live reconciliation of cash on hand to the tally sheet. Cash was \$2,160 and the tally sheet was \$1,430. This variance was due to the inefficiencies discussed above. Best efforts should be made to either use the cash register or maintain an accurate tally sheet. Reconciliations to cash on hand should be performed at the end of each day.
- Many of the Clerk's revenue items come with prenumbered documents. Dog licenses, birth certificates, marriage licenses etc. However the pre-numbering is never used as an effective reconciliation tool or control.
- Revenue reconciliations have never been performed to the Town's General Ledger or the Treasurer's records.
- Cash is turned over about every two weeks and sometimes three weeks. This contradicts Massachusetts General Laws and the Treasurer's policy to turn cash over weekly.

We suggest the Finance Office work with the Town Clerk's Office to improve the cash handling process currently in place.

### *Landfill*

Register controls were adequate; the till balance agreed to the register tape without exception. Turnovers are timely and cash storage is now secure.

### *Wannacomet Water*

Wannacomet does not use a register but instead uses a strong box and maintains a rolling balance of transactions. Register controls were adequate; the box balance agreed to the manual log without exception. Turnovers are timely and cash storage is secure.

### *Town Collector*

Three registers are maintained in the Town Collector's Office. The controls were adequate; the till balances agreed to the register tapes without exception. Turnovers are timely and cash storage is secure.

### *Cafeteria*

When reconciling the till balance, on first pass a discrepancy of \$26 existed, however \$25 was located under the cash drawer to balance to within \$1. Additionally, the cashier noted that she sometimes leaves the cash register unattended (locked) to stock snacks and perform other duties. Often students will leave money on the register to pay for items when unattended thus leaving these funds at risk. Deposits are made daily, thus turnover is timely.